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SUBJECT: JAPANESE ATTITUDES ON BUSINESS WITH RUSSIA REMAIN CAUTIOUS

Classified By: Ambassador J. Thomas Schieffer for Reasons 1.4 (b), (d)

¶1. (C) SUMMARY: Japanese business sentiment toward economic opportunities in Russia remains cautious. Japanese business and government interests note concerns about the risks of doing business in Russia, continued uncertainty following Russia's invasion of Georgia, problems with the transport of goods inside Russia, and lack of GOR working-level movement on several proposed investment opportunities as obstacles to increased Japanese economic engagement. While traditional energy and autos trade relations remain strong, Japanese penetration into other Russian consumer markets as well as in the development of Russia's Far East remain sluggish. END SUMMARY.

PUSH FOR INVESTMENT BEYOND MOSCOW AND ST. PETERSBURG

¶2. (C) Ministry of Economy, Trade and Industry (METI) METI Trade Policy Bureau Director for Russia, Central Asia and the Caucasus Noriaki Kojima noted the difference he saw in perceptions between Russian and Japanese participants when he made a presentation at an annual Japan-Russia investment forum in St. Petersburg in early September. Kojima noted several Russian regional government and business representatives sought to emphasize business opportunities, while the Japanese participants seemed to be attending the forum out of a sense of obligation. According to Kojima, the Russian government decided this year's central theme would be expanding investment opportunities outside Moscow and St. Petersburg. METI Senior Vice Minister Sanae Takaichi led a delegation of around 250 Japanese government and business representatives from the auto, energy, telecom and finance industries. Responding to Emhoff's questions about the timing of the event, Kojima said it was originally proposed for June, but because many Japanese firms have shareholders' meetings at that time, it was rescheduled, prior to the Russian invasion of Georgia, for September.

JAPANESE WARY OF POOR INFRASTRUCTURE

¶3. (C) Kojima identified four negative perceptions of the Russian investment climate among Japanese companies: (1) complicated and time-consuming administrative procedures; (2) sometimes incomprehensible regulations; (3) insufficient infrastructure; and (4) the poor quality of Russian manufactured goods. Russia's infrastructure is a particular weakness, Kojima said, explaining bottlenecks in Russia's saturated ports hurt efficient distribution of Japanese-made automobiles throughout Russia. Japan and Russia have had several high-level meetings on developing the Trans-Siberian

railroad for transporting Japanese exports from Siberia westwards to European Russia, but Kojima said the Russian side's expectations of Japanese involvement are unclear. Kojima also said many Japanese firms, including Toyota, are wary of transporting sensitive and fragile high-tech goods by rail.

¶4. (C) Shunsuke Nakagawara, Director of Mitsui's Russia-CIS-Baltics Business Development Center and a key figure in the trading house's corporate strategic planning for the Russian market, echoed Kojima's sentiment. In a subsequent meeting with Emboff, Nakagawara noted Japanese perceptions of the Russian business climate have changed significantly over the past several months. Talking about the annual investment forum, he said many Japanese participants did not know how to react in the immediate aftermath of the Russia-Georgia conflict. Over the past month, Japanese industry has been following U.S. and E.U. reactions to events in Russia and Georgia very closely. As far as the forum's theme of investment prospects outside of Moscow and St. Petersburg, Nakagawara and Mitsui Senior Counselor Takehiro Togo said the Russian Far East continues to have promise as a destination for Japanese investment. (Bio note: Togo was Japan's Ambassador to Russia from 1996-1999). Mitsui is participating in the Sakhalin II project, which should make its first LNG delivery in 2009, and Togo is encouraged by Gazprom's participation in the venture as a guarantor of stability. Mitsui also concluded a MOU with Russian Railways (RZD) and Russkaya Troyka to develop a weekly "all Japan block train" cargo shipment to Moscow and St. Petersburg starting in early 2009.

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¶5. (C) Itaru Otowa, Vice Director of the Institute for Russian and NIS Economic Studies at the METI-affiliated Japan Association for Trade with Russia and the NIS (Japanese acronym ROTOBO), also said Japanese industry is closely watching U.S. relations with Russia. Otowa said Japanese companies operating in Russia are customarily risk averse. Otowa points to recent investments by auto manufacturers, including Toyota's commencement of production of passenger vehicles in St. Petersburg in December 2007, as a turning point toward additional Japanese foreign direct investment, with other manufacturers likely to follow suit. However, difficulties in adapting the Japanese just-in-time system to prevailing conditions in Russia as well as a lack of sufficiently trained local employees and a historic lack of consumer-oriented quality control are obstacles to expanding Japanese engagement in Russia's manufacturing sector.

¶6. (C) COMMENT: By the numbers, Russia remains a significant Japanese trade and investment partner in the traditional sectors of autos and energy. In the first half of 2008, autos, which account for 76% of Japan's total exports to Russia, rose 68% year-on-year, while crude oil imports from Russia rose nearly 39%. Russia remains a growing export market for transportation amid declining global sales, and some manufacturers, such as Komatsu, which began building a hydraulic shovel plant in Yaroslavl in July, continue foreign direct investment in anticipation of sustained future growth.

However, an apparent lack of momentum coming out of the September investment forum plus a wait-and-see sentiment related to events in Georgia and the response of U.S. government and business may temper Japanese economic expansion in Russia. END COMMENT.

SCHIEFFER